SOME ASPECTS OF THE INCOME TAX[1]

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In considering the income tax, the subject may be discussed either in the abstract to determine whether any income tax constitutes an advisable method of taxation, or accepting the principle that such a tax is sound, the law imposing it may be examined to see whether it is so framed as to provide for a form of taxation, which is equitable in its application and desirable in its methods of administration and of collection. Since I have been asked to treat the subject primarily from the point of view of the business man and to discuss the practical workings of the law, rather than its theory, I shall not enter into the question of whether an income tax as such is an advisable method of taxation, although I am inclined to favor this form of raising revenue for the government, if the tax is equitably levied and administered. For the same reason, I shall not touch on the very interesting economic question of whether income derived from investments should be taxed differently from that resulting from personal service.

It may safely be assumed that taxes are generally unpopular among those upon whom they fall, but it is the function of government, particularly in a democracy, such as ours, to so levy and administer them, as to cause the least possible hardship and to so distribute them as to make every citizen pay his or her just proportion of the expenses of the government and of the protection enjoyed. We have become so accustomed to having the income of our government provided by customs, internal revenue and other forms of indirect taxation, that any direct tax is bound to be disliked. We are not used to the parental form of many European governments and, therefore, an income tax, with its resultant inquisitorial methods and prying into the affairs of individuals is, from its nature, bound to cause dissatisfaction, a large part of which is possibly unwarranted. We have, however, the right to expect that the tax should be fairly applied and should be administered in such a way as to cause the least possible friction and hardship and a minimum of expense in its collection.

[1] This article was written in November, 1914.—The Editor.

It is the duty of every citizen to do his part towards maintaining the government under which he lives, but he should be relieved from unnecessary exactions.

Adam Smith, in *The Wealth of Nations*, has given certain maxims with regard to taxation, which have become almost axiomatic in their general adoption. Among various rules, which he lays down, are the following, namely, that the subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities, that is, in proportion to the income which they respectively enjoy under the protection of the state; that every tax ought to be levied at the time and in the manner in which it is most likely to be convenient for the contributor to pay it; that every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state. Applying these particular rules to the income tax, as imposed by our law, we find that it meets none of these requirements. The citizens of this country are not required under our laws to contribute towards the support of the government as nearly as possible in proportion to their respective abilities. The tax is levied in a manner which is not generally convenient to the contributors who pay it. The expense of collection is so great that the tax is not so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury.

According to figures, made public by the secretary of the treasury on October 23, 1914, 357,598 individuals, of whom 278,835 were married and 78,763 were single, paid income tax for the period ended December 31, 1913. This is considerably less than one-half of 1 per cent of the population of the United States. Even assuming that each one of those married represents a family of five, we find that the tax was paid in respect to the income of some 1,472,938 individuals, or, in other words, that about 98½ per cent of the people of the country escaped this form of taxation. As comparatively few pay any other form of direct tax, the result is that the great bulk of our population contribute nothing directly to the state. Experience in other countries, where an income tax is an established means of taxation, has shown that the rate of such a tax steadily increases as the demand for revenue by the state becomes greater, and it is to be presumed that there will be the same tendency in the United

States. There is danger in having a tax, which already forms a substantial part of the income of our government, and which probably will be called upon to provide an increasing portion of the expenses of the nation, fall upon so small a percentage of the population. This tends to encourage extravagance in government, as legislators are more apt to incur additional expenditures, when the revenue to meet them is secured by increasing the amount contributed by comparatively few of the people of the country, while they would be likely to hesitate to do so if this necessitated the placing of additional burdens upon the entire citizenship. But even a greater danger lies in the very fact of the popularity of the tax among the great mass of our people through their escaping this form of taxation. When the matter recently came up for discussion as to how to increase the revenue of the government, in order to make up for the falling off of customs receipts, the very first proposition was to increase the amount of the income tax. This met with considerable favor, but the proposition that the exemption should be decreased met with instant objection.

To examine all of the details and possible criticisms of the law would lead too far, but attention may be called to a few of the points which have arisen.

In the case of married people living together, only one exemption of $4,000 can be claimed, even though they have separate sources of income. While the act itself simply provides that but one exemption can be claimed, the regulations go further and provide that either one return shall be made of the income of both, or that if separate returns are made, one shall be attached to the other. Cases may arise where one of the parties is unwilling to disclose his or her income to the other and it hardly seems justifiable that the regulations should read something into the act which is not written there. Would it not be better to allow a definite exemption to each individual, whether married or not, who enjoys a separate source of income, with possibly an additional exemption for dependent wife and children?

The act provides that living expenses may not be deducted from the taxable income. On the other hand, the farmer, a part or all of whose crops are consumed as food by himself and his family, is not required to include in his income the value of the crops thus consumed. He is, therefore, to that extent receiving an allowance for living expenses.

Under the most recent ruling, it is not permissible to rate securities, and losses can be charged against income only when actually incurred, although even that is now questioned, unless the losses are sustained in the business in which the taxpayer is engaged. There seems to be no good reason why investors should not have the option of either keeping their books on the basis of carrying securities at actual cost and charging losses and crediting profits, as they arise, or of valuing their holdings at the market price once a year and either crediting or debiting income, as the case may be, with the increased or decreased value, as established by such prices. This privilege was extended to corporations under articles 111 and 135 of the Regulations, which permitted corporations not only to rate securities, but also to amortize bonds purchased above par, so as to maintain them on the interest basis on which they were purchased. Under the most recent ruling the privilege extended under article 111 of the Regulations has been withdrawn and it is now ordered that in computing the amount of their taxable income, corporations may take into account only actual profits and losses. Needless to say, every individual having once chosen the method he wishes to adopt should be compelled to maintain that method year by year, although it might be provided that upon giving sufficiently long notice, he should be authorized to change his system of accounting. Even under the provision that only actual losses or profits can be taken into account, many complications arise. The following example is only typical of the difficulties encountered in construing the law. A man buys, let us say, 100 shares of stock at $120 per share. A few weeks afterwards, he buys another 100 shares at $110 per share and then sells 100 shares at $115 per share. Has he lost $5 per share on his original purchase, or has he made a profit of $5 per share on his second purchase, or has he come out even in respect to half of his holdings as against his average cost?

The law in specifying income covers it not only as received, but as accruing. It is not clear whether the reverse is provided for, namely, whether accrued interest included in the purchase price of securities can be deducted from the interest when received. According to the language of the act it seems as if, in the case of bonds purchased say on June 1st for a stated price, the buyer would have to report as income a full six months' coupon collected on July 1st, notwithstanding the fact that five-sixths of such coupon has

been paid by him to the seller, as part of the purchase price, while the seller would escape taxation in respect to that part of his income. There has been no authoritative ruling on this, although it has been informally stated by the treasury department that the buyer need include only the proportion of the interest actually received by him and that the seller is liable for the tax on the amount of interest which he received as part of the purchase price. In the case, however, of bonds, the tax in respect to which has not been assumed by the debtor corporation, the amount of the tax will be deducted from the coupon, when presented by the buyer, with the result that he must, in order to protect himself from loss, deduct from the purchase price the proportionate share of the tax chargeable to the seller. If the seller claims that he is exempt, while the buyer is not, the resulting complications and difficulties become even greater.

The act provides that corporations may deduct from their gross income the amount of interest accrued and paid within the year on their indebtedness to an amount of such indebtedness not exceeding one-half of the sum of their interest-bearing indebtedness and their paid-up capital stock outstanding at the close of the year. If the intent of this provision was to legislate against corporations, which have only a nominal capital stock, in order to reduce the amount of their taxable income, it seems as if that purpose could be fully covered by making this provision apply only to corporations incorporated after the passage of the act, as there seems no sound reason why corporations in existence prior to that time should not be permitted to deduct the entire amount disbursed by them in interest on their indebtedness.

The provisions in the law as to the method for arriving at the taxable income of corporations show that it has been attempted to do by indirection, what it has been urged to do by direct legislation. It is clear that by the provision forbidding corporations to deduct from their net income dividends received from other corporations, it was intended to discriminate against holding companies. It hardly seems fair that companies, which by the nature of their business, or through the location of their property, are compelled to hold portions of their property in a perfectly legitimate manner through the medium of another corporation, should be penalized for doing so, in order to meet public clamor against what are generally known as holding companies. It is not within the province of this discussion

to enter into the question as to whether holding companies, as such, are desirable, or not, but it must be conceded that in many instances it is necessary for one corporation to hold the stock of another. Why, therefore, should there be a penalty when a perfectly proper purpose is fulfilled? Take, for example, the case of a railway corporation, which owns a line in the state of Texas, which it can hold under the Texas law only through a Texas corporation. The latter must pay the income tax of 1 per cent upon its net income and then the parent company must again pay the same tax on dividends received, with the result that a tax of 2 per cent must be paid in respect to this part of its income.

The law provides for the collection of the tax at its source, in respect to certain classes of income, and this has given rise to the greatest cause of complaint. The intent of the law is that, so far as possible, the payer of income and not the recipient, shall be held responsible for the payment of the normal tax. This method of collection is an importation from Europe and is copied, to a great extent, from the provisions of the English income tax law. It has, however, apparently been overlooked that in England substantially everybody, except the person dependent upon daily wages, is taxed and that practically no one in receipt of any other form of income is exempt. The framers of the law have also failed to take into account the difference in the size of the two countries and in their methods of business. They have failed to take into consideration the methods by which collections of income are made here; of the manner in which coupons on American bonds are collected; of the fact that most coupons in this country are guaranteed tax free and of the wide diversification of investments by even the class of small investors.

I am frank to say that the provisions for collecting the tax at the source have proved less troublesome than I feared, when, as a member of the committee, I participated in May, 1913, in framing the report on the income tax of the committee on finance and currency of the Chamber of Commerce of the State of New York. This has been due, however, not to the provisions of the law itself, but to the possibly temporary rulings of the treasury department. During the first few months of the operation of the law, these provisions proved very burdensome, due, among other causes, to the variety of forms, to the lack of uniformity in their printing, to the

doubt existing as to many points of the law, to the new and revised instructions issued from day to day, to the necessity of stating bond numbers on certificates, to the impossibility of knowing how much in the way of records and reports the government might require and what information and records withholding agents and debtor corporations would need for their own protection and also to the difficulty of securing the coöperation of the public. The regulations gradually became simplified and, after six months' trial of ownership certificates, the treasury department revised the list of certificates for the purpose of eliminating repetition, as well as of standardizing the certificates, as a result of which the method of procedure has become considerably simplified. In this process of revision, the number of certificates to be used has been reduced from 19 to 10. The regulation requiring that numbers of bonds be written on the certificates, after being enforced during the first few weeks of the operation of the law, has now been rescinded, the last ruling having waived this provision until further notice. The advantage of enforcing this regulation is so questionable and the task so unwieldy, that it is to be hoped that this requirement will be eventually waived altogether.

The collection of the tax at its source forces the disclosure of investments to others, which is objectionable to our own citizens and to some extent at least militates against American investments by foreigners, who are disinclined to give this information.

Under the scheme of certificates, to be executed when collecting coupons, it was at first required that non-resident aliens, claiming exemption, should attach certificates to their coupons, giving their names and addresses, even in the case of bonds issued exclusively in foreign currencies and held entirely abroad. Later this was modified and the treasury department ruled it would be sufficient if a responsible bank or banker executed the certificate, provided it was accompanied with a list of the names and addresses of the individual holders. Since then there has been a further modification and the ruling, now in force, permits banks and bankers to use a form of certificate, which does not require the names of the holders to be disclosed. The banks and bankers must, however, agree to furnish the names, if requested to do so. Even this is, in many instances, not possible, as foreign banks or bankers paying such coupons on behalf of American corporations can themselves only secure the information as to who are the individual holders of the obligations, if the holders are

ready to declare themselves. This they are frequently unwilling to do, as under the terms of the bonds which they hold, they have the absolute right to receive the interest, without any deduction for American taxes, and therefore see no reason why they should give information to others as to their investments. This is particularly the case in France, where securities are scattered among a large number of small investors. The result is that, failing to secure proper exemption certificates, the American corporation may be held liable to our government for the tax, even though by the nature and form of its bonds, to which the interest appertains, it is perfectly clear that the bonds are held by non-resident aliens.

The machinery provided by the law is so cumbersome and complicated as to make it difficult of comprehension to the average person and has placed a burden upon collecting agencies, which is out of all proportion to the amount collected by them. As the tax is administered, it has become necessary for all those who collect interest and dividends to create additional machinery for handling the large amount of extra work involved and, as a result, all such agencies have been placed under heavy expense. It does not seem fair that the government should force corporations and individuals to bear this expense and do work, which properly belongs to the government, without compensation.

In England this has been recognized to some extent at least by the allowance of what is commonly known as "poundage" to those collecting foreign dividends. The English law provides that a person entrusted with the payment of dividends, who shall perform all necessary acts, so that the income tax thereon may be assessed and paid, shall be entitled to receive as remuneration an allowance of so much (not being less than three pence) in the pound of the amount paid, as may from time to time be fixed by the commissioners of the treasury. This applies only to dividends, payable out of the revenue of foreign and colonial states and dividends of foreign and colonial companies.

It is interesting to note that the regulations require the debtor corporation to surrender the certificates to the collector of internal revenue monthly, with the result that the corporation is at once deprived of the only evidence it ever possessed for its own protection from tax liability on the interest to which these certificates appertained. Therefore, the only way the corporation has of protecting itself is to undertake the labor and expense of making duplicate lists for its own files.

Experience has shown that it is with considerable difficulty that corporations, whose bonds are tax free and the interest on which is, therefore, payable without deduction of the tax, can secure from the holders of small amounts of these bonds properly drawn exemption certificates to enable the corporation to secure a refund of the tax thus withheld. As a result, the government receives taxes to which, under its own law, it is not entitled. There is little doubt that thousands of ownership certificates covering payment of coupons and registered interest, are executed by bondholders without regard to their own financial condition and that many do not claim exemption, because the company pays the taxes. The bondholder, knowing that the debtor corporation will in any event pay the interest in full, naturally applies his exemption to some other form of income. As a result, the corporation, under the tax free provision, is made to assume the normal tax of such bondholder in respect to that income. A marked example of this is the election permitted by the government to trustees and other fiduciaries to claim or not to claim exemption from collection at the source. Naturally trust estates waive any claim of exemption upon such payments, as they thus throw the responsibility for the tax upon the debtor corporation in virtue of the tax free covenant. In the absence of the tax free covenants, as for example, the collection of rents belonging to trust estates, it has been found that trustees prefer to claim exemption from withholding at the source. As the ultimate liability for taxation depends upon the status of the beneficiaries of the trust, concerning which the debtor corporation has no information or means of information, the practice permitted and encouraged by the government tends to render the debtor corporation liable for taxes, regardless of whether or not the actual beneficiaries of the income are subject to the tax.

The method of collecting the tax has entailed tremendous expense upon corporations disbursing interest to a mass of investors. It has resulted in burdening the companies with a vast amount of additional detailed labor, both in the handling of the prescribed certificates and in the preparation of the monthly and yearly reports to the tax collector. One of the large railway corporations in this country states that the collection of the income tax at the source necessitated more than doubling the clerical force at its coupon and interest desks. This particular corporation estimates that it will have to handle about 100,000 tax certificates per year, of which all

those which show tax liability must be listed monthly in duplicate and each one of these monthly returns requires the signature of the treasurer or assistant treasurer of the company making the return.

It appears that the actual cost to corporations incident to withholding the tax at the source is from 10 per cent to 20 per cent of the amount collected for the government, an imposition upon the intermediary corporation of a very considerable service for the government without compensation. Indeed, in most cases, the companies themselves, on account of the tax free clause in their bonds, are paying practically the entire tax, which under the regulations they are called upon to retain and are thus put to a heavy expense, in order to give evidence to the government why they pay the tax and why it is not greater. It is to be assumed that it costs the government on its part at least as much to receive and tabulate these returns, as it does the corporations to make them and that, therefore, the entire expense involved, covering the collection and recording of the tax thus withheld, amounts to from 25 per cent to 30 per cent of the amount collected.

In the case where interest is not paid by the corporation itself, but through a fiscal agent, such as a bank or trust company, additional expense is involved. Before the income tax law went into effect most of these banks and trust companies, acting as paying agents, considered themselves amply repaid for the work involved by the interest gained by them on the deposit of the funds received for this purpose. In view of the additional work required on account of the income tax law, many of the banks and trust companies have felt compelled to charge the companies a percentage on the amount paid, to compensate them for their trouble.

The case of one of the larger New York trust companies is typical of the burdens placed upon collecting agencies. Of the corporate interest paid by this company during the first six months of 1914, 62 per cent was paid on ownership certificates claiming exemption and 38 per cent on certificates not claiming exemption. In respect of approximately 89 per cent of the interest paid to those not claiming exemption, the tax had been assumed by the debtor corporation and as a result the amount of taxes actually withheld by the trust company itself amounted to less than one-twentieth of one per cent of the total amount of interest collected and disbursed by the trust company during that period. The expense and work

connected with this can readily be imagined and all this to collect for and pay over to the government less than one-twentieth of one per cent of the total amount of interest disbursed by this particular company.

In collecting coupons for depositors, the experience has been that, notwithstanding the increased facilities, there is considerable delay. On the first of every month on which interest is payable, particularly in January and July, these delays extend over a period of four or five days and in some cases even longer, which is naturally very inconvenient to bondholders and in the case of larger holders the loss in interest is considerable.

As illustrating another of the difficulties which withholding at the source entails, mention may be made of notes given in payment of rent, interest or other income. To be certain that any note for an amount exceeding $3,000 is not issued for such a purpose and therefore subject to deduction, every discounter of such a note is bound to inquire into the purpose for which it was originally issued, as the regulations clearly state that if a person, in acquiring such a note from a previous owner, has omitted to make deduction of the allowance for the tax, he can look for relief only to the person from whom the note was obtained, as the debtor is required to deduct, withhold and pay to the collector of internal revenue the amount of the normal tax, which may be due thereon.

As to the amount withheld from salaries, it is necessary to make each month a list of those whose salary is in excess of $3,000 per annum, which in the case of those having a large number of employees is a considerable undertaking. This is required monthly, by reason of the changes in salaries and positions that may take place during the period affecting the amount to be withheld. As the employer is not required to withhold, until over $3,000 is paid, it is necessary to follow up the salary of each employee receiving more than that sum, to ascertain at what time of the year the first deduction from his pay is to be made. The employer must then obtain from such employee his exemption certificate, if he is entitled to one, and give instructions as to the amount to be withheld. It frequently happens that more is withheld from parties than they are required to pay the government. For instance, in the case of a married man receiving $5,000 salary, the employer is required to withhold $10. In the employee's income return to the government, he may, however, show

exemption other than that allowed by paragraph C of the law, and, therefore, he is entitled to a refund from the withholding agent, upon filing a copy of his annual return with such agent. It can readily be seen how much trouble and annoyance this causes both the employer and the employee.

A complication which is only just developing is, that individual bondholders, who reported in their returns for the period ended December 31, 1913, bond interest as having been subject to collection of the tax at the source, are being called to account by the collectors of their districts, who are, of course, unable to verify the return in this respect. Inquiries and complaints received from individual bondholders would seem to indicate that the internal revenue department has neglected or has found it impossible to assemble the information received from different sources as to the income of each individual taxpayer. That is only one of the difficulties in providing for deduction at the source in a country of the extent of ours, which does not exist in a country of a more limited area, such as England.

The officials have gone to the extreme in asking for information, much of which hardly appears necessary or even germane to the act. Only recently a request has been sent out to all corporations to furnish the internal revenue department with a list of preferred and common shareholders, of the number of shares held by each and of the amount of dividends paid to each during the ten months ended December 31, 1913. In view of the fact that dividends are not subject to the normal tax, it hardly seems that any sound purpose can be accomplished by this, and that it was obviously designed to verify the returns of parties subject to the additional tax. In the case of a corporation with many shareholders, the burden thus attempted to be thrown on the corporation was certainly disproportionate to the information of actual value and to any beneficial results which the department could hope to gain. It would have been a comparatively simple matter to furnish a list of those to whom dividends amounting to over a certain amount had been paid, but in order to secure information as to the limited number of large payments, the government required a complete statement of all payments. In the case of one corporation, this requirement involved the preparation as of December 31, 1913, of a stock list of considerably more than 20,000 names, and the preparation of a list of quarterly dividend payments

during the year to this large number of stockholders, including a comparison of the dividend lists of each of the quarters and the assembling of the payments made in each quarter to each stockholder. On a computation that the preparation of the dividend list alone would involve over one hundred days' work by one clerk and a considerable expense, for which there seemed to be no legal warrant, the position was taken by this corporation that the information would not be furnished without the exhibition of specific legal authority for its request. No attempt has thus far been made to produce such authority and the government has apparently not urged this requirement further, in respect to corporations who have protested.

It is to be remarked that the agency which withholds does not pay the amount thus withheld to the government until the tax itself is payable, namely, in June of the following year. It results from this that the withholding agent has the use of the money thus withheld for a period of at least six months and possibly eighteen months without interest, while the recipient of the income is deprived of the use of that amount for a corresponding period. It should further be noted, that if the withholding agent, through bankruptcy or otherwise, fails to pay the amount withheld to the government, as may readily happen in the case of parties of limited responsibility, the recipient is responsible for the payment of the tax, notwithstanding that it has already been withheld from him.

According to the language of the act, many Americans living abroad can, as a practical matter, escape taxation, even though all their income is derived from American investments. Article D of the act states that a person residing in a foreign country shall make his return in the place where his principal business is carried on within the United States. There is no provision for such a person making his return elsewhere if he has no place of business in this country. Of course, if he fails to make any return and is discovered, he is guilty of a misdemeanor, and yet there seems to be no way provided for enforcing the law in regard to this.

It has recently been ruled that members of a partnership are not entitled to follow up the sources of the income of the partnership and avail themselves of the exemptions to which they may be entitled on certain classes of that income. As partnerships, as such, are not taxed, it would seem proper that such of the income as is

derived, for example, from dividends on stocks should be exempt as to the normal tax in the hands of the individual partner, who receives it.

Embarrassment has been caused in connection with the issue of additional bonds under open mortgages made before the tax law became effective, when such mortgages contain the tax free covenant. Aside from the trouble and expense of making issues of such bonds not subject to this clause, it is very objectionable to have two kinds of bonds outstanding under the same mortgage, one of which is tax free and the other not. The existence of two such classes of bonds adds to the burdens incident to the making and recording of interest payments and requires unusual vigilance on the part of paying agents to distinguish between the coupons appertaining to the two classes.

Eminent legal authorities have called attention to the crudity of the act, but it is interesting to note that since the law has gone into effect, there have been not only the general regulations, consisting of 199 articles, but also 87 official treasury decisions, 26 official letters and 1 executive order, in addition to a very large number of letters and rulings furnished by the commissioner and his assistants in response to inquiries received. Many of these regulations, rulings and decisions are not in themselves clear and in a number of cases they substitute departmental construction for the law itself. For example, under the strict provisions of the act, each party through whose hands income passes, has the right to withhold the normal tax, notwithstanding that it has already been withheld by someone else and, in addition, the recipient of the income in question is also made liable. This provision is so manifestly unfair, that the treasury department has decided not to enforce it. Article 34 of the regulations relieves everyone, except the original debtor from withholding. In other words, the provisions of the law seem sufficiently unreasonable for an administrative branch of the government to nullify it.

The act is silent as to the method to be adopted by partnerships in arriving at their profits or losses, to be divided among or be borne by the partners. Even the treasury department seems to be uncertain how to construe the law in this regard and its rulings are quite unclear. The custom of practically all firms, whether dealing in merchandise or securities, is to take an inventory of their assets at the end of their fiscal year in order to determine the results of the year's business. This necessitates valuing the assets at a fair market value,

so as to avoid dividing what may be called "paper profits." The act, which exempts partnerships as such from the income tax, does not provide whether this may be done by partnerships, or not, but under the most recent ruling, which reverses a former one, individuals and corporations are not allowed to do so. There seems to be no good reason why this should not be permitted, as any amount written off in any one year will appear in a future year's income return to the extent that all or part of such amount may be recovered, when the assets, which have been written down, are actually sold. The only possible explanation for not permitting individuals and corporations to reduce the value of their assets to market value, if this is lower than cost, is that it is feared that in a period of depreciation of values, it might result in a heavy falling off of the revenue to be received by the government from the income tax.

The construction of the provision that only losses incurred in trade may be deducted is a curious one. The treasury department has now ruled that it will not permit deductions from income to be claimed for losses actually incurred in the sale of real or personal property, unless the person claiming such deductions is engaged in the business of dealing in the property in connection with which the loss has been incurred. In other words, a merchant, who has invested money in securities or real estate, would not be permitted to deduct from his income the amount lost by him in the realization of such an investment. While the language of the act is unclear in regard to this, it had generally been understood that this would be permitted and it may safely be assumed that the great majority of returns for 1913 by persons who had incurred such losses, were made on this theory. It hardly seems just that the merchant, who has purchased a piece of real estate as an investment and sells it at a profit, must include that profit in his return, while if he disposes of it at a loss, he should not be permitted to deduct the loss from his income, although the professional real estate speculator may do so. The unfairness of this is manifest and it can hardly be supposed that this was the intent of the framers of the law. It shows, however, how necessary it is that the act should be so written as to be beyond misunderstanding, so as to avoid the necessity of having departmental authorities construe it.

Article 43 of the regulations may well be cited as an example of leaving to others the determination of matters, which, according to

the act itself, is vested in the government. By this article, direction is given to withholding agents or others with whom certificates executed by an agent are filed, either to stamp such certificates, that they are satisfied as to the identity and responsibility of the agent or to require evidence as to the authority of such agent to so act. While this is a convenience, there seems to be no warrant for this in the act itself.

It may, however, fairly be questioned whether a law, which is subject to so much misunderstanding and requires so many rulings as to its meaning, is in itself sound. The law is so unclear as to many points that a number of the rulings are in the nature of a compromise and it hardly seems within the function of the treasury department to supplement defects of the law.

The least we have the right to expect is that the law should be absolutely clear as to its requirements and that if it is not, it should be amended to make it so. Apparently the authors of the act had not a very definite idea in their own minds as to just what should be taxed and as to the manner in which the collection should be made. The act is curious in that, while dealing as a whole in generalities, it attempts to go into detail as to certain points, with the natural result of causing further complications. For instance, it particularly exempts losses arising from fires, storms or shipwrecks, not compensated for by insurance or otherwise, but does not permit exemption for losses from floods, earthquakes, war, or other similar happenings.

What is the remedy, and how can the law be improved, so as to prevent unnecessary burdens upon business and be made less exacting in its requirements from individuals? Assuming that the income tax has come to stay and leaving aside the question as to the lowering of the exemption, it seems that information at the source could well be substituted for collection at the source and the tax be directly collected from recipients of income.

The present act provides for the filing of certain returns by individuals and corporations and for the assessment of the tax on the basis of these returns. Why should it not be made incumbent upon each individual to file with the proper authorities a return of his or her entire income from whatever source derived, much as is done under the present act, permitting claims by the individual for such exemptions, as may be provided in the law and then when the actual assessment of the tax is made, make it the duty of the individual to pay his or her own full tax? If a check upon the correctness of these

returns is needed, it could be provided that all those corporations, partnerships and individuals, who pay income to other persons, should file at stated intervals, lists showing the nature and amount of the payment and the names of the persons to whom it was made. This would not require the filing by individuals of exemption certificates with those who pay income and would much simplify the present cumbersome and expensive method, while at the same time it would enable the treasury department to check up the returns of individuals to such an extent as to provide against dishonesty. It is not likely that there will be many cases of understatement of income. The government could be fully protected by incorporating in the law very severe penalties for any deliberate withholding of facts or understatement of income. The work and expense now resting upon paying agents would be much less and the burden of collection would fall on the government, where it properly belongs, and upon the individual who is the person whom it is proposed to tax.

It has been quite impossible within the scope of an article, such as this, to cover the ground thoroughly and to show all the defects of the law. It seems clear, however, that the act needs revision to remedy its faults and to make its requirements readily understood. Such a revision should preferably be undertaken by a paid commission of experts, as no congressional committee, with the limited time at its disposal and the pressure of other matters, can adequately deal with so intricate and complex a subject. The congressional committee might well determine the broad principles of the law, but the act itself should be drafted and its details worked out by experts, who could then report their conclusions to the committee for submission to Congress.

I would summarize as follows:

1. The exemption is too high and should be reduced to such a figure as to make only those exempt who have substantially no source of income, except their wages.

2. The system of collection at the source should be abandoned and a system of collection from the recipient substituted, with information at the source and severe penalties for false statements.

3. The law should be so clarified as to make it comprehensible to the average person, so as not to require administrative departments of the government to construe it or to correct its defects; a method which is dangerous in itself and is certain to lead in time to endless litigation between the government and its citizens.